In the

Supreme Court of the United States

OCTOBER TERM

No.

JACK D. MATHESON,
Petitioner,

vs.

GEORGE ARMBRUST,
Respondent

Petition for A Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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TERM, 1961

No. _____

JACK D. MATHESON,
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vs.

GEORGE ARMBRUST,
Respondent

Petition for A Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Petitioner prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit affirming the judgment in favor of respondent entered by the United States District Court for the District of Oregon.

OPINIONS BELOW

The opinions of the District Court and the Court of Appeals are printed in Appendices A and B hereto, as neither yet appears in the printed reports.

JURISDICTION

The judgment of the Court of Appeals was dated November 28, 1960, and was entered November 28, 1960. The jurisdiction of this Court is invoked under 28 USC 1254 (1), c. 646, 62 Stat. 928.

QUESTION PRESENTED

Is there any private civil action between citizens of a single state for damages for fraud in the sale of corporate securities of which any Federal Court has jurisdiction?

STATUTES AND REGULATIONS

15 USC 78 (j) (b) (Section 10(b) of the Securities Exchange Act of 1934), c. 404, § 10, 48 Stat. 891

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

17 CFR 240.10B-5 (Rule X-10B-5 of the Securities and Exchange Commission)

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or the mails, or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumsances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

15 USC 78aa (Section 27 of the Securities Exchange Act of 1934), c. 404, § 27, 48 Stat. 902; c. 804, 49 Stat. 1921; c. 646, § 32(b), 62 Stat. 991; c. 139, § 127, 63 Stat. 107

"The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions of law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the

district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (USC, title 28, Secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts."

STATEMENT OF THE CASE

Matheson, a resident of Oregon, was the president, general manager and owner of all the outstanding stock (100 shares) of Willamette Hauling Company, an Oregon corporation. Armbrust, also a resident of Oregon, inquired of Matheson at Portland, Oregon in April, 1954, regarding the purchase of this stock. Negotiations were undertaken but were broken off.

The District Court found that Matheson at Portland, Oregon, telephoned to Armbrust at Pasco, Washington, on May 6, 1954, and told him that he would make a better price and furnish more complete financial data

if Armbrust would return to Portland and resume negotiations. Armbrust returned to Portland where he negotiated for, and purchased, the stock. The court found that Armbrust was induced to make this purchase by fraudulent misrepresentations made to him for that purpose concerning the financial condition and the earnings of the company.

There was no diversity of citizenship among the parties; so by motion and answer Matheson sought dismissal of the action for lack of jurisdiction and for failure to state a claim upon which relief can be granted because the action does not "* * * arise(s) under the Constitution, laws, or treaties of the United States" 28 USC 1331, Pub.L. 85-554, § 1, 72 Stat. 415.

The Court of Appeals held otherwise, saying:

> "This action is based upon a violation of section 10 (b) of the act* and rule X-10B-5, and is therefore governed by section 27 of the act. This section expressly confers exclusive jurisdiction on the district courts with respect to all suits in equity and actions at law brought to enforce any liability or duty created by section 10 (b) and rule X-10B-5. Section 28 (a) of the act, 15 USCA Section 78bb (a), recites in part that the rights and remedies provided by the act 'shall be in addition to any and all other rights and remedies that may exist at law or in equity * * *'"

* Securities Exchange Act of 1934, 15 USCA 78 j (b).

> "Actions brought to enforce any liability or duty created by section 10 (b) and rule X-10B-5 are therefore additional to state and any other federal actions. Appellee, as plaintiff, may have had a choice between suing in state or federal court to recover damages for the fraud which appellant perpetrated. If so, the long-established principle is applicable, that 'the party who brings a suit is master to decide what law he will rely upon.' *The Fair v. Kohler Die & Specialty Co.*, 228 US 22, 25."

This completely begs the question which the case at bar presents in starkest simplicity: Is the private remedy for the fraudulent sale of securities a common law tort action or the creation of the Securities Exchange Act of 1934?

REASON FOR GRANTING THE WRIT

The Court below decided a fundamental question as to the interpretation and effect of Section 10b of the Securities Exchange Act of 1934 in a way in conflict with applicable decisions of this court, with the decisions of other Courts of Appeal on the same matter, and with its own decision in *Fratt v. Robinson*, 203 F2d 627, 634-5.

Section 10b simply declares "unlawful" the conduct described in Rule X-10B-5. Neither provides for a civil liability or a civil remedy. They were intended to fill out the public remedies against fraudulent buyers. *Birn-*

baum v. Newport Steel Corp., 193 F (2d) 461 (CA 2, 1951); Loss, Securities Regulations pp. 806-11. A private civil remedy has been constructed judicially on the theory that conduct which the statute declares unlawful is by implication a common law tort. Restatement of Torts, Section 286; Loss, Securities Regulation, pp. 1043-1066; 45 ABAJ 129, 131; 18 Law and Contemporary Problems 505. This is not a "federal" remedy.

In the absence of diversity of citizenship federal courts can have jurisdiction of an action to redress this common law tort only if it can be said to "arise(s) under the Constitution, laws, or treaties of the United States", 28 USC 1331-2; *Byers v. McAuley*, 149 US 608, 618 (1892); *Shoshone Mining Co. v. Rutter*, 177 US 505, 513 (1900); *Gully v. First National Bank*, 299 US 109, 112. This was found impossible in a case involving a "common law tort" claim said to arise under the Safety Appliance Acts. *Jacobson v. NY, NH and Hartford Railroad Company*, 206 F2d 153 (CA 1 1953). Cf. *Bell v. Hood*, 327 US 678. The difficulty of justifying it in a case said to arise under Section 10b of the Securities Exchange Act is clearly indicated in *Darwin v. Jess Hickey Oil Corp.*, 153 Fed Supp 667; *Beury v. Beury*, 127 Fed Supp 726; and *Remar v. Clayton Securities Corporation*, 81 Fed Supp 1014 (D. Mass 1949). In the Remar case, the court said:

> "The issue is whether plaintiff's cause of action springs from the common law of tort which merely takes as its standard of due care the Securities and Exchange Act * * * or is brought to enforce a liability or duty directly created by the Securities and Exchange Act. After some hesitation, I have concluded that, within the meaning of Section 27, plaintiff is enforcing a liability created by the Securities and Exchange Act. To be sure, the statute created the liability by implication, not by express words. But once the liability was created, its extent was to be measured by what is sometimes called a federal rather than a state common law * * *."

Cf. Erie R. Co. v. Tompkins 304 U.S. 64 (193

The Court of Appeals which decided the case at bar rejected this view in *Fratt v. Robinson*, 203 Fed 2d 627, when it held (page 634-5) that an action under Section 10b and Rule X-10B-5 was governed by the three-year Washington statute of limitations applicable to actions "for relief upon the ground of fraud." It rejected the argument that because the action was based upon a federal statute the two year Washington statute of limitations applicable to any cause of action not otherwise provided for should be applied. The reasoning which produced that result precludes the result reached in the case at bar because it clearly identifies this as a common law action for fraud; as such, it is not actionable in a federal court without an independent basis of jurisdiction.

The federal statute is no more the basis of liability herein than it was in *Montana-Dakota-Utilities Co. v. Northwestern Public Service Co.*, 341 US 245, in which this court said, at page 252:

> "If the petitioner's grievances arise from active fraud and deceit, it gains nothing from the federal act * * * the federal act adds nothing to fraud as an actionable wrong, and, therefore, to find a cause of action of this character would only be to dismiss it for want of diversity."

The case at bar should have been dismissed for lack of jurisdiction for the same reason. Any other result would construe the statute and the rule so as to destroy a previously well established body of jurisdiction and jurisprudence, *Lauritzen v Larson*, 345 US 571, 578, 590-593 (1953).

There can be no question that the complaint and findings herein would sustain relief upon the ground of fraud under the common law of the State of Oregon, *Heise v. Pilot Rock Lumber Company*, 70 Or. Adv. 1359, 352 P 2d 1072. Therefore, the right which plaintiff sought to enforce in this action is not:

> "* * * such that it will be supported if the Constitution or laws of the United States are given one construction or effect and defeated if they receive another." *Gully v. First National Bank*, 299 US 109, 112.

What the court below overlooked is that "the federal nature of the right to be established is decisive—not the source of the authority to establish it." *Gully v. First National Bank*, supra, at page 116.

This distinction was clearly made by Judge Medina in *Howard v. Furst*, 238 Fed 2d 790 (CA 2, 1960). That was a stockholder's derivative action against corporate directors for alleged waste and to enjoin the voting of proxies which had been obtained in violation of section 14 (a) of the Securities Exchange Act of 1934 and rule X-14-9. The court dismissed the complaint for lack of jurisdiction on the ground that:

> "Appellant's claim is for violation of state created rights, in no real or substantial sense dependent upon the provisions of the Securities Exchange Act of 1934 * * *" (238 Fed 2d at Page 793)

This case was followed in *Brouk v. Managed Funds, Inc.*, (C.A., 8) January 31, 1961, 29 US Law Week 2327 which held that the Investment Companies Act didn't confer federal jurisdiction of a suit by a registered investment company to recover damages from its officers and directors for breach of their fiduciary duties as directors by conduct which violated the federal statute.

CONCLUSION

The confusion surrounding the nature of a cause of action for fraud in the sale of securities has been the subject of much comment. Loss, Securities Regulation pp. 1043-1066; 45 ABAJ 129. The need for clarification by this Court is strikingly demonstrated by the pendency, concurrently with this one, of the petition for a Writ of Certiorari in *Hooper v. Mountain States Securities Corp.*, 282 F2d 195 (CA 5), and the imminent filing of such a petition in *Brouk v. Managed Funds, Inc.*, (CA 8 January 31, 1961) and probably in *Ellis v. Carter* (CA 9). The importance of the problem is indicated by the fact that the Securities and Exchange Commission intervened and filed a brief in the Court of Appeals herein. The instant case provides an ideal vehicle for this Court to announce once and for all whether the Securities Exchange Act has created new private federal civil remedies for fraud in the sale of securities. If not, the Court below has exceeded its jurisdiction.

Respectfully submitted,

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APPENDIX A

OPINION OF THE DISTRICT COURT

MEMORANDUM OPINION

Upon considering the evidence and the respective briefs of counsel, the Court is of the opinion that, as shown by a preponderance of all of the evidence in the case, the defendant Matheson intentionally employed a scheme to defraud plaintiff in the transaction culminating in the purchase by plaintiff of 100 shares of capital stock of Willamette Hauling Company, a corporation, and the payment by plaintiff of the sum of $30,000.00 as consideration for the taking of a five-year promissory note from the defendant Willamette Hauling Company.

This Court is of the further opinion that this Court has jurisdiction of plaintiff's cause pursuant to §10(b) of the Securities Exchange Act of 1934 (15 U.S.C.A. 78j(b) and Rule X-10B-5 of the Securities and Exchange Commission (17 C.F.R. 240.10b05) in that the 100 shares of capital stock aforesaid constitute a "security" under said section and Rule and that an instrumentality of interstate commerce was used by the defendant Matheson in the furtherance of said scheme to defraud, viz: defendant Matheson's long distance call from Portland, Oregon, to the plaintiff at Pasco, Washington.

The Court is of the opinion from a preponderance of the evidence that the defendant Matheson clearly violated §2 of Rule X aforesaid by making the following material inducements and representations to induce plaintiff to purchase said 100 shares of capital stock and to advance the sum of $30,000.00 as aforesaid to Willamette Hauling Company:

(1) Presented to plaintiff the financial statement of Willamette Hauling Company for the year ending December 31, 1953, which grossly misstated the net worth of said Company and the value of said stock in an amount in excess of $20,000.00;

(2) Grossly misstating the Hauling Company's earnings for the first five months of the year 1954 in an amount of more than $30,000.00; and

(3) Grossly misrepresented the "cents per revenue miles" that the Hauling Company's trucks were earning in the year 1953 and the early part of the year 1954, in that the Hauling Company, with the knowledge, if not by way of direction, of the defendant Matheson, failed to report and show upon its books at least 15,000 miles of travel by the trucks.

The Court is convinced that the aforesaid material misrepresentations were made by the defendant Matheson with the knowledge that they were false and that

even so Rule X-10B-5 §2 aforesaid provides for damages in the event of a breach thereof under the doctrine of "equitable fraud", being in the nature of the making of a material misrepresentation although innocently made.

The Court has no hesitation in holding that the defendant Matheson is liable to the plaintiff for violation of said Rule and that plaintiff is entitled to have and recover judgment against the defendant Matheson in the sum of $30,000.00, less the sum of $9,279.95 (bankruptcy dividend—plaintiff's exhibit Q), provided said amount is actually paid to the plaintiff as a pro tanto satisfaction. And that the plaintiff is entitled to further relief against and from the defendants Matheson and Willamette Hauling Company by way of having the following contracts declared void as having been made by the defendants Matheson and Willamette Hauling Company in violation of §10(b) of the said Act and Rule X-10B-5 aforesaid:

(1) Document entitled Agreement to Sell and Purchase, dated May 21, 1954, between Jack D. Matheson, referred to therein as the "Seller," George Armbrust, therein referred to as the "Purchaser" and Willamette Hauling Company, an Oregon corporation, therein referred to as "Corporation" (Plaintiff's exhibit A);

(2) Document entitled Escrow Agreement, dated May 21, 1954, executed by Jack D. Matheson as "Seller" and George Armbrust as "Purchaser" and acknowledged by Robert Leedy as escrow agent (plaintiff's exhibit B);

(3) Written Assignment, dated May 21, 1954, of a promissory note of Willamette Hauling Company, payable to the order of George Armbrust in the principal amount of $30,000.00 (plaintiff's exhibit D); and

(4) Document entitled Chattel Mortgage, from Willamette Hauling Company to Jack D. Matheson, recorded in the County Clerk's office for Multnomah County, Oregon, in Book 222, Mortgages, p. 129, so far as the same shall be applicable to plaintiff.

See Errion v. Connell, 236 F2d. 447 (9 Cir. 1956); Ruth v. Hickman, 67 Oregon Advance Sheets 269 (1958).

The Court is of the further opinion that plaintiff is entitled to recover of and from the defendant Willamette Hauling Company reasonable compensation for any services performed and moneys advanced on behalf of said corporation; however, this question is reserved until the Court is advised as to whether or not such claim is a matter to be presented to the bankruptcy court or to be determined in this cause.

Plaintiff is entitled to recover costs of and from defendant Matheson in connection with the relief granted against said defendant and further costs against the defendant Willamette Hauling Company in connection with any relief granted against said defendant.

Counsel for plaintiff is requested to submit within 30 days from the date hereof findings, conclusions and judgment order in conformity with the foregoing, without reference to the aforesaid reserved matter.

Dated July 28, 1959.

/s/ WILLIAM G. EAST,
U. S. District Judge.

[Endorsed]: Filed July 28, 1959.

APPENDIX B

OPINION OF THE COURT OF APPEALS

Before: CHAMBERS and HAMLEY, Circuit Judges, and BOWEN, District Judge

HAMLEY, Circuit Judge:

George Armbrust, purchaser of one hundred shares of the capital stock of Willamette Hauling Company, brought this action to cancel the contract of sale as void and to recover damages. Named as defendants in addition to the company were Jack D. Matheson, who sold the stock to Armbrust, and other persons since dismissed from the action. After a nonjury trial judgment was entered for plaintiff, the monetary award being in the sum of $30,000. Appealing to this court, Matheson contends that the district court was without jurisdiction over the subject matter or the person, and that appellee failed to state or prove a claim upon which relief may be granted.

The relevant facts as found by the trial court and not disputed here may be briefly stated. Matheson, a resident of the State of Oregon, was the owner of all of the outstanding corporate stock of Willamette Hauling Company, consisting of one hundred shares. He was also the president and general manager of the corpora-

tion. In April 1954 Armbrust, also a resident of the State of Oregon, inquired of Matheson at Portland, Oregon, as to the possibility of purchasing this stock. Negotiations were undertaken but were broken off.

Thereafter, on May 6, 1954, Matheson at Portland, Oregon, telephoned to Armbrust in Pasco, Washington. During this conversation Matheson stated that he would make Armbrust a better price and furnish more complete financial data than during the original negotiations if Armbrust would return to Portland and resume negotiations. Armbrust returned to Portland following this telephone call and resumed negotiations which led to the sale of the securities to Armbrust on May 22, 1954.

In connection with this transaction Matheson intentionally undertook and practiced a scheme to defraud Armbrust. This scheme involved, among other things, the making of gross misstatements concerning the financial condition and earnings of the company. Armbrust relied upon these representations and was deceived thereby, as a result of which he was damaged in the sum of $30,000.

It was alleged in the complaint that the described conduct on the part of Matheson constituted a violation of section 10(b) of the Securities Exchange Act of 1934,

15 U.S.C.A. § 78j(b)[1] and rule X-10B-5 of the Rules and Regulations of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5.[2] District court jurisdiction was therefore asserted and exercised under section 27 of the act, as amended, 15 U.S.C.A. § 78aa. This section provides, among other things, that the district courts shall have exclusive jurisdiction of all suits in equity and actions at law "brought to enforce any liability or duty created by this title or the rules and regulations thereunder. * * *"[3]

[1]Section 10(b) of the act provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

[2]Section 240.10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud.

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

[3]Reference was also made in the complaint to section 29(b) of the act, 15 U.S.C.A. § 78cc(b), which provides:

"(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation."

Appellant's contention that the district court lacked jurisdiction over the subject matter of the action is predicated in part upon the introductory language of section 10. As indicated by this language, the use or employment of a manipulative or deceptive device or contrivance of the kind referred to in section 10(b) and rule X-10B-5 is not violative of the act unless there has been a direct or indirect use of some means or instrumentality of interstate commerce or of the mails or of a facility of a national securities exchange. The only such means, instrumentality or facility which appellant was found to have used in this case was the interstate telephone lines between Portland, Oregon, and Pasco, Washington.

Appellant argues that the court did not find that this instrumentality was used in perpetrating the fraud. What the court found, according to appellant, is that the fraudulent scheme was practiced upon Armbrust after the latter returned to Portland, so that the fraud all took place in Portland without the use of any instrumentality of interstate commerce. In presenting this argument appellant relies upon that part of the findings of fact quoted in the margin.[4]

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[4] ". . . That the use of said long-distance public telephone between Portland, Oregon, and Pasco, Washington, on May 6, 1954, by Matheson on behalf of himself and Willamette Hauling Company constituted a direct use of an instrumentality of interstate commerce in the fraudulent scheme thereafter practiced upon Armbrust . . . ."

All that is required to establish a violation of section 10 is a showing that a means, instrumentality or facility of a kind described in the introductory language of that section was used, and that in connection with that use an act of a kind described in section 10(a) or (b) occurred. Errion v. Connell, 9 Cir., 236 F.2d 447, 455.

The finding of fact upon which appellant relies is somewhat ambiguous, since it recites that the use of the long-distance telephone constituted a direct use of an instrumentality of interstate commerce "in" the fraudulent scheme "thereafter" practiced upon Armbrust. But this ambiguity is completely resolved by the court's further finding that "commencing with the said long-distance telephone call by Matheson on May 6, 1954, and continuing to the culmination of the transaction on or about May 22, 1954, at Portland, Oregon, Matheson intentionally undertook and practiced a scheme to defraud Armburst. * * *"

As so clarified it must be held that the trial court expressly found that the fraud was practiced in connection with the use of the long-distance telephone between Oregon and Washington. It follows that in so far as the requirements of section 10(b) are concerned, the findings of fact establish jurisdiction in the district court over the subject matter of the action.

Appellant further contends, however, that since the district court found what was in effect common-law fraud, the state courts of Oregon and not the federal courts have subject-matter jurisdiction.

This action is based upon a violation of section 10(b) of the act and rule X-10B-5, and is therefore governed by section 27 of the act. This section expressly confers exclusive jurisdiction on the district courts with respect to all suits in equity and actions at law brought to enforce any liability or duty created by section 10(b) and rule X-10B-5. Section 28(a) of the act, 15 U.S.C.A. § 78bb(a), recites in part that the rights and remedies provided by the act "shall be in addition to any and all other rights and remedies that may exist at law or in equity. * * *"

Actions brought to enforce any liability or duty created by section 10(b) and rule X-10B-5 are therefore additional to state and any other federal actions. Appellee, as plaintiff, may have had a choice between suing in state or federal court to recover damages for the fraud which appellant perpetrated. If so, the long-established principle is applicable, that "the party who brings a suit is master to decide what law he will rely upon." The Fair v. Kohler Die and Specialty Co., 228 U. S. 22, 25.

We therefore hold that the fact that appellee may have had an adequate civil remedy in the courts of Oregon did not deprive the district court of jurisdiction over the subject matter of this cause of action.

Appellant next contends that section 10(b) of the act is not applicable with regard to "face to face" negotiations outside the organized security market between private individuals as owner and purchaser in an isolated transaction for the sale of the entire capital stock of a corporation. Fratt v. Robinson, 9 Cir., 203 F.2d 627, is cited in suport of this proposition. Since this was such a transaction, and since there is not diversity of citizenship between appellant and appellee, it is argued that the court lacked jurisdiction over the person of appellant.

Both the Fratt and Errion cases involved "face to face" security transactions independent of any security-dealing business house or security exchange. In both of those cases it was held, directly contrary to appellant's contention, that section 10 and rule X-10B-5 cover security transactions outside the established securities-transfer business. See Fratt at page 630; Errion at page 453.

The district court did not lack jurisdiction over appellant in the respect urged.

Finally, appellant urges, section 10b and rule X-10B-5 afford no private civil remedy, and appellee has therefore failed to state or prove a claim upon which relief may be granted. Conceding that this court has sanctioned recovery under rule X-10B-5 by the seller of securities, appellant points out that we have never passed upon the question of whether such a remedy is available to a purchaser of securities.

Much of appellant's argument under this point is directed to the contention that it was not intended that section 10(b) would afford a private civil remedy to any person. But this contention was rejected in the Fratt and Errion cases, both of which involved plaintiffs who were sellers. The only question remaining is whether Congress intended to draw a distinction between sellers and buyers affording the former a remedy under section 10(b) as in the cases last cited, but not affording a remedy to a buyer.

No such distinction is indicated in section 10(b). Under that section it is unlawful to use or employ the proscribed device or contrivance "in connection with the purchase or sale of any security." Appellant, however, apparently bases his argument for such a distinction on the fact that certain civil remedies are specifically made available to purchasers of securities in certain situations by sections 11 and 12 of the Securities

Act of 1933, as amended, 15 U.S.C.A. §§ 77k and 77l: In essence, this is an effort to limit the scope of section 10(b) of the Exchange Act by recourse to the interpretive rule of *expressio unius est exclusio alterius.*

This same line of reasoning advanced in an effort to preclude sellers from a civil remedy under section 10(b) was rejected by this court in Fratt v. Robinson, 9 Cir., 203 F.2d 627, 632. In Securities Exchange Commission v. Joiner Corporation, 320 U. S. 344, 350-51, it was noted that however helpful this and other rules of construction may be, the courts will nevertheless "construe the details of an act in conformity with its dominating general purpose; will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy."

As before noted, the text of section 10(b) makes express reference to purchases as well as sales. In promulgating rule X-10B-5 to implement that section the Commission has provided relief for purchasers as well as sellers. Under these circumstances and in conformity with the view expressed in Joiner, quoted above, we find no room for application of the rule of statutory construction to which reference has been made.

We subscribe to the view expressed in Fischman v. Raytheon Mfg. Co., 2 Cir., 188 F.2d 783, wherein buyers

of common stock were afforded a remedy under section 10(b) of the Exchange Act notwithstanding the fact that the basis of their claimed fraud also constituted a violation of section 11 of the Securities Act of 1933. See also Hooper v. Mountain States Securities Corporation, 5 Cir., 282 F.2d 195.

Affirmed.

(Endorsed) Opinion Filed Nov. 28, 1960.

Frank H. Schmid, Clerk.

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NO. 740

In the Supreme Court of the United States

OCTOBER TERM, 1961

JACK D. MATHESON,

Petitioner,

v.

GEORGE ARMBRUST,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

RESPONSE TO PETITION

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NO. 740

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

RESPONSE TO PETITION

Respondent, GEORGE ARMBRUST, urges that the petition for writ of certiorari in the above-entitled cause not be granted for the following reasons:

Decision of the Court below is NOT in conflict with any Court of Appeal decision but rather in harmony with the Second, Third, Fifth and Ninths Circuits which have passed on the question.

Although this Court has not passed upon the question presented, the decision of the Court below is not in conflict with any decision of this Court or of the Court of Appeals in any Circuit. Indeed, the Court below decided

the question presented by Petitioner harmoniously with each and every Court of Appeals which in the past dozen years has ever had occasion to pass upon the question: namely, the Second Circuit, *Fischman* v. *Raytheon Mfg. Co.* (1951), 188 F.2d 783; Third Circuit, *Slavin* v. *Germantown Fire Ins. Co.* (1949), 174 F.2d 799; Fifth Circuit, *Hooper* v. *Mountain States Securities Corp.* (July, 1960), 282 F.2d 195, cert. denied Feb. 20, 1961, 29 U.S. Law Week 3242; Ninth Circuit, *Fratt* v. *Robinson* (1953), 203 F.2d 627; *Errion* v. *Connell* (1956), 236 F.2d 447.

In spite of Petitioner's contention to the contrary, the Court below decided the jurisdictional question presented precisely in accord with its first decision in *Fratt* v. *Robinson* (9 Cir., 1953), 203 F.2d 627, 37 A.L.R. 2d 636. In turn, the Court below initially decided this question in the *Fratt* case upon principles laid down by this Court in *Bell* v. *Hood* (1946), 327 U.S. 678.

The only *contra* decision which we have found is that of the late Judge Moore of the District Court in *Beury* v. *Beury* (D.S., Va., 1954), 127 F. Supp. 786. Even in respect to that decision, the Court of Appeals for the Fourth Circuit by *dicta* in its dismissal of the improvidently brought appeal expressed disagreement with the lower court's reasoning, *Beury* v. *Beury* (4 Cir., 1955), 222 F.2d 464.

Petitioner presents no substantial federal question that warrants this Court's consideration.

Though important, the question presented by Petitioner is not a substantial federal question when measured by the crystal clear language of Sections 27 (Pet., p. 3)

and 28 (Pet., p. 22) of the Securities Exchange Act of 1934 and the unanimity of opinion of four Courts of Appeal agreeing with the Court below that the District Court had jurisdiction to entertain Respondent's action as an injured investor against the Petitioner who sold to him securities in direct violation of Section 10(b) and rule. The opinion of the Court below on this question is unquestionably clear and sound (Pet., p. 22).

Even putting aside for the moment the grave error of Petitioner in contending that jurisdiction of the District Court rested on 28 USC § 1331 instead of Section 27 of the Act, he still remains in error in contending that Respondent's cause did not arise under the law of the United States. In the District Court the Respondent, as plaintiff, alleged and proved facts which showed that the Petitioner as defendant had sold securities in violation of Section 10(b) and its rule resulting in damage to Respondent (Tr. 3). Merely because those facts as established might also have been actionable in the courts of the State of Oregon under a common law theory of fraud did not deprive Congress of the right and authority to declare unlawful conduct in violation of Section 10(b) and its rule where the security sale involved use of instrumentalities of interstate commerce. This is particularly true where Congress by Section 27 of the same Act conferred exclusive jurisdiction upon the District Court to entertain all suits and actions at law arising from violation of the Securities Exchange Act of 1934.

Petitioner changes nothing by labeling respondent's action as one based upon common law fraud when it

clearly is based upon the violation of Section 10(b) and 29(b) (Pet. p. 19, note 3) of the Securities Exchange Act of 1934.

This Court does not have presented here a situation comparable to that in *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.* (1951), 341 U.S. 245, or in *Howard* v. *Furst* (2 Cir., 1960), 238 F.2d 790, where the claimed violation of a Federal Act was, at most, a collateral issue to the principal claim for damages arising from the fraudulent conduct of corporate directors. In those cases, the fraudulent conduct in itself did not encompass the violation of the Federal Act. In the case at bar, the very facts which Petitioner choose to label as common law fraud constitute inclusively the direct violation of Section 10(b) and its rule.

The particular question herein raised by Petitioner was well answered by the Court in *Remar* v. *Glayton Securities Corporation* (D. Ct. Mass., 1945), 81 F. Supp. 1014, which in upholding the view of the Court below said:

> "The issue is whether plaintiff's cause of action springs from the common law of tort which merely takes as its standard of due care the Securities and Exchange Act . . . or is brought to enforce a liability or duty directly created by the Securities and Exchange Act. After some hesitation, I have concluded that, within the meaning of Section 27, plaintiff is enforcing a liability created by the Securities and Exchange Act. To be sure, the statute created the liability by implication, not by express words. But once the liability was created, its extent was to be measured by what is sometimes called a federal rather than a state common law. . . . "

The only use which the Federal courts have made of the common law tort principle as defined in Restatement, Torts, Section 286 is to use it as a doctrine for reasoning that when Congress enacted Section 10(b) and made it clearly to benefit investors—a specific as distinguished from a general class of persons—that Congress must have intended to have granted by implication a civil remedy for those investors against violators of the Act. Common law is used, if at all, to find legislative intent; not to create a cause of action apart from the expression of the legislature. This is pointed out by Professor Louis Loss in describing the judicial basis for the implied liabilities. He says in his treatise "Securities Regulations" (1951), at page 1044:

> "The other basis of the implied liabilities is the common law tort doctrine of private action based on violation of a statute. . . . It is all a matter of 'legislative intention'. The courts have to be sure they are only 'finding' and not 'making' the law. . . ."

To borrow from Petitioner, the "stark simplicity" of the question raised is the ferreting of legislative intent by interpreting the words of Section 10(b) and that spells out a case arising under the laws of the United States. *Gully* v. *First National Bank* (1936), 299 U.S. 109, 112. Furthermore, this Court has indicated that on occasion it might borrow common law principles as developed by state courts in order to fashion a Federal rule, but that when it does so, the rule as fashioned nevertheless becomes and remains a federal rule and cannot be said to be a state law. *Clearfield Trust Co.* v. *United States* (1943), 318 U.S. 363, 366, 367.

Furthermore, no court has yet pointed out that when it was using a common law principle in relation to a federal statute that it was referring to state as distinguished from federal common law. Compare *Erie Railroad Co.* v. *Thompkins,* 304 U.S. 64, 69 with *Hinderland* v. *La Plata Co.*, 304 U.S. 92, wherein Mr. Justice Brandeis spoke for the majority of this Court in both cases on the same day of April 25, 1938.

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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No. 740

In the Supreme Court of the United States

OCTOBER TERM, 1960

JACK D. MATHESON,
PETITIONER

v.

GEORGE ARMBRUST

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN OPPOSITION

ARCHIBALD COX,
Solicitor General,
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In the Supreme Court of the United States

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN OPPOSITION

The Solicitor General submits this brief on behalf of the Securities and Exchange Commission, as amicus curiae, in opposition to the petition for a writ of certiorari. The Commission appeared in the Court of Appeals in support of the position of the respondent.

OPINIONS BELOW

The opinion of the Court of Appeals (Pet. 17-26) is reported at 284 F. 2d 670. The opinion of the District Court (Pet. 12-16) is unreported.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on November 28, 1960. The petition for a writ of certiorari was filed on February 17, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). See also Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78aa.

QUESTION PRESENTED

Whether, under the provisions of Section 27 of the Securities Exchange Act of 1934, conferring on the federal district courts exclusive jurisdiction of violations of that Act, a federal district court has jurisdiction over an action between private parties based on violations of the anti-fraud provisions of that Act and of the regulations thereunder.

STATUTE AND RULE INVOLVED

Pertinent provisions of the Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*, and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, are set forth in the petition (Pet. 2-4).

STATEMENT

According to the detailed findings of fact, which the petitioner does not dispute, the petitioner sold to the respondent at a price of $90,000 the outstanding shares of stock of the Willamette Hauling Company (the "Company") (R. 43, 44, 45). In carrying out the sale of these securities, the petitioner intentionally practiced a scheme to defraud the respondent

(R. 38, 45). The fraudulent scheme commenced with an interstate telephone call from the petitioner to the respondent inviting negotiations for the sale of the securities and continued throughout subsequent negotiations until the sale was consummated (R. 45). The scheme involved use of a false financial statement and other misrepresentations relating to the financial condition of the Company (R. 45-48). The respondent was forced to cause the Company to file a voluntary petition in bankruptcy five months after he had assumed control (R. 51, 52).

The petitioner's use of the interstate telephone in furtherance of his fraudulent scheme to sell securities was found by the District Court to be conduct in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder (R. 44). After also finding that the injury suffered by the respondent was a direct and proximate result of this violation, the District Court awarded the respondent money damages and declared void several contracts entered into in connection with the sale (R. 52-54).

The Court of Appeals affirmed, specifically holding that the district court had properly assumed jurisdiction over the action pursuant to Section 27 of the Securities Exchange Act of 1934.

ARGUMENT

The proposition that a violation of Rule 10b-5 gives rise to private rights, although of substantial importance and never passed upon by this Court, has been established in three Courts of Appeals in addi-

tion to the court below,[1] and is clearly correct. There is no conflict.

The petitioner's assertion that relief for violation of such rights may be obtained only in the state courts was either expressly or impliedly rejected in the cases just cited. The petitioner's argument that an action under the rule is not one which "arises under the Constitution, laws or treaties of the United States," as provided in 28 U.S.C. 1331,[2] ignores Section 27 of the Securities Exchange Act, which provides that "[t]he district courts of the United States . . . shall have exclusive jurisdiction . . . of all suits in equity and actions at law brought to enforce any liability or duty created . . ." by that Act or rules thereunder. It is under this section, as noted by the court below (Pet. App. 22), that jurisdiction vests.[3] Even if it

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[1] *Hooper* v. *Mountain States Securities Corporation*, 282 F. 2d 195 (C. A. 5), *certiorari denied*, No. 603, this Term; *Fischman* v. *Raytheon Manufacturing Company*, 188 F. 2d 783 (C. A. 2); *Speed* v. *Transamerica Corporation*, 99 F. Supp. 808 (D. Del.), affirmed, 235 F. 2d 369 (C. A. 3); *Fratt* v. *Robinson*, 203 F. 2d 627 (C. A. 9), and *Errion* v. *Connell*, 236 F. 2d 447 (C. A. 9). Other cases where federal courts have assumed jurisdiction over private actions for violations of Rule 10b-5 include: *Slavin* v. *Germantown Fire Insurance Company*, 174 F. 2d 799 (C. A. 3); *Kardon* v. *National Gypsum Company*, 69 F. Supp. 512 (E. D. Pa.); *Northern Trust Company* v. *Essaness Theatres Corporation*, 103 F. Supp. 954 (N.D. Ill.); *Hawkins* v. *Merrill, Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W. D. Ark.); *Robinson* v. *Difford*, 92 F. Supp. 145 (E. D. Pa); *Fry* v. *Schumaker*, 83 F. Supp. 476 (E. D. Pa); *Mills* v. *Sarjem Corporation*, 133 F. Supp. 753 (D. N.J.).

[2] 62 Stat. 930, as amended, 72 Stat. 415.

[3] *Cf. Montana-Dakota Utilities Company* v. *Northwestern Public Service Company*, 341 U. S. 246, which involved Sec-

were not "exclusive,"[4] it would seem that such an explicit grant of jurisdiction to a federal court would necessarily be controlling.

Since Rule 10b-5 defines manipulative and deceptive devices in the purchase and sale of securities, it is to be expected that violations thereof also might constitute conduct actionable under state law whether such causes of action are predicated upon common law fraud or statutory violation, state or federal. Indeed, Section 28 of the Securities Exchange Act provides that the "rights and remedies" provided by that Act are "in addition to any and all other rights and remedies that may exist at law or in equity". But Congress did not intend to permit the broad purpose of the Act, "to keep the channels of interstate commerce, the mail, and national security

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tion 317 of the Federal Power Act, a jurisdictional section similar to Section 27 of the Securities Exchange Act. It was there held that the district court had jurisdiction over the subject matter of the suit. 311 U.S. 249. The quotation in the petition from that case (page 9) is wholly inapplicable to Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, which, unlike the provisions of the Federal Power Act there involved, are specifically designed to outlaw fraudulent conduct.

[4] Because federal jurisdiction is "exclusive," several state courts have refused to adjudicate violations of the Securities Exchange Act. See *e.g.*, *Mekrut* v. *Gould*, 188 N.Y.S. 2d 6, 9; *American Distilling Company* v. *Brown*, 51 N.Y.S. 2d 614, 184 Misc. 431, *affirmed*, 295 N.Y. 36, 64 N.E. 2d 317; *Standard Power & Light Corporation* v. *Investment Associates*, 29 Del. Ch. 593, 51 A. 2d 572, 579. For a discussion of the legislative history of Section 27 of the Securities Exchange Act, see *American Distilling Company*, *supra*, 51 N.Y.S. 2d 614.

exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation" in the purchase and sale of securities, to be frustrated by variations in state law.[5]

Although jurisdiction in this case was based on Section 27 of the Securities and Exchange Act, 15 U.S.C. 78aa, the ~~plaintiff~~ petitioner relies for the most part upon cases arising under 28 U.S.C. 1331. Even under that section, however, this Court has held that the fact that a plaintiff may have a choice to frame his complaint under state or federal law does not deprive the federal court of jurisdiction where the plaintiff elects to base his case upon federal law. *Bell* v. *Hood*, 327 U. S. 678, 681; *The Fair* v. *Kohler Die Company*, 228 U. S. 22, 25.

Petitioner also relies upon *Howard* v. *Furst*, 238 F. 2d 790 (C. A. 2) and *Brouk* v. *Managed Funds*, (C. A. 8), January 13, 1961. Without conceding

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[5] *Hooper* v. *Mountain States Securities Corporation*, *supra*, 282 F. 2d at 202. The court there noted that Rule 10b-5 "greatly expands the protection frequently so hemmed in by the traditional concepts of common law misrepresentation and deceit, the requirement of privity, proof of specific damage, inadequacy of the right of rescission or right to recover up to par value of stock of a much greater market value. To these difficulties would have to be added the geographic obstacle of suit in a common forum against multi-state defendants scattered as far as the fraudulent device required." Id. at 201. Accord: *Connelly* v. *Balkwill*, 174 F. Supp. 49, 56 (N. D. Ohio). *Beury* v. *Beury*, 127 F. Supp. 786 (S.D. W. Va.), cited by petitioner (Pet. 7), is apparently to the contrary. The Court of Appeals for the Fourth Circuit, however, in the course of dismissing the appeal as not involving a final order, expressed by way of dictum its disagreement with the district court. See *Beury* v. *Beury*, 222 F. 2d 464, 465.

the correctness of those decisions, we submit they are clearly distinguishable from the present case, since they were not concerned with the provisions of the statute or rule here involved. *Howard* dealt with the Commission's proxy rules promulgated under Section 14(a) of the Securities Exchange Act, and held that the Act provided no cause of action in favor of a corporation, the directors of which had solicited its stockholders by proxy statements prepared in contravention of the proxy rules, concluding, as the petition notes (page 10), that the claim was solely "for violation of state-created rights, in no real or substantial sense dependent upon the provisions of the Securities Exchange Act of 1934 relative to proxy statements." (238 F.2d at 793.) In *Hooper v. Mountain States Securities Corporation*, *supra*, an action under Rule 10b-5, the Court of Appeals for the Fifth Circuit specifically refused to apply the language of *Howard* beyond the confines of Section 14(a).

In *Brouk*, where the court held that under the Investment Company Act of 1940 it had no jurisdiction over an action for damages against directors of an investment company, it nevertheless noted its agreement with the principles expressed in actions under Rule 10b-5, including *Hooper* v. *Mountain States Securities Corporation*, *supra*. See pages 14-16, 27 and 33 of the slip opinion.

The petitioner's contention (Pet. 8) that the decision of the court below conflicts with its prior decision in *Fratt* v. *Robinson*, 203 F. 2d 627, which also involved a private suit under Rule 10b-5, is errone-

ous. In *Fratt*, where a dismissal of the complaint was reversed, the court, as in the present action, held that the district court had jurisdiction over the subject matter pursuant to Section 27 of the Securities Exchange Act.* 203 F. 2d at 631-633. Since the Securities Exchange Act provides no statute of limitations for actions under Rule 10b-5, the court "borrowed" the state statute of limitations governing actions for fraud. This, however, is not the equivalent of making the suit itself a common law fraud action. As this Court said in *Textile Workers* v. *Lincoln Mills*, 353 U. S. 448, in the course of outlining the substantive federal law applicable to Section 301(a) of the Labor Management Relations Act:

> "Federal interpretation of the federal law will govern, not state law. * * * But state law, if compatible with the purpose of § 301, may be resorted to in order to find the rule that will best effectuate the federal policy. * * * Any state law applied, however, will be absorbed as federal law and will not be an independent source of private rights." (*Id.* at 457).

See also *Kemar* v. *Clayton Securities Corporation*, 81 F. Supp. 1014, 1017-1018 (D. Mass.).

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* See also the Ninth Circuit's holding in *Errion* v. *Connell*, 236 F. 2d 447, 454.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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March, 1961.

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